United States Department of Agriculture

Food and Nutrition Service

Mountain Plains Region

1244 Speer Boulevard
Denver, CO 80204

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Reply to Attn. of: SP-94-67
CACFP-391
SFSP-231

Subject: Cost Plus Percentage of Cost Contracting

To: STATE AGENCY DIRECTORS (Special Nutrition Programs) - Colorado ED, Colorado DH, Colorado SS, Iowa, Kansas, Missouri ED, Missouri DH, Montana OPI, Montana DHES, Nebraska ED, Nebraska SS, North Dakota, South Dakota, Utah, Wyoming ED, Wyoming DHSS

Recent audit activity by the USDA Office of Inspector General has disclosed some problems with FNS guidance relating to cost-plus-percentage-of-cost (CPPC) contracting. A publication sanctioned by **Food Distribution Division**, entitled Contract Purchasing: A Manual for Food Service Supervisors, Volume II, (page 10), states that under certain circumstances CPPC contracts are acceptable. As you know, 7 CFR Parts 3015 and 3016 as well as Office of Management and Budget (OMB) Circular A-102, A-110 and the Federal Acquisition Regulations uniformly prohibit CPPC contracts. No exceptions are cited. The Food Distribution guidance is based on an interpretation of a July 1985 letter from OMB that is included as Appendix A of the publication.

We have reevaluated our guidance and our position on this issue. In our view, there are virtually no instances in which CPPC contracts are acceptable. The only conceivable deviation is a contract in which the cost-plus-percentage method is used as the means of constructing the final price, but the final, full cost is known and can be compared to the costs quoted by other suppliers. For example, if a school district is making a purchase of ground beef and receives a bid of $1.39 a pound (the cost) plus 10% (the markup), this bid is acceptable because it can be compared to those of other suppliers. In this situation the full cost is known and, therefore, the resultant contract is effectively a fixed-price one. The same school district, however, could not enter into a contract for ground beef at an unspecified cost plus 10%.

The original guidance from the OMB letter was based on the premise that the supplier that has no control over the cost would, therefore, have no incentive to inflate cost to increase profit. That premise is problematic. Although a supplier may have no control over the cost of a commodity itself, the supplier may have control over ancillary costs such as shipping. The supplier could also select the product from the more expensive source, by-passing lower prices, and creating more profit. When suppliers' profits are directly contingent upon suppliers' costs, an incentive to increase cost exists.

Consequently, State Agencies must be advised that any endorsement of the section of the purchasing manual discussing CPPC contracts is now rescinded and States and local agencies should not rely on that document as a basis for an exemption to the Federal prohibition against CPPC contracts. FNS will attempt to ensure that the next reprinting of this document clearly states that the general policy of FNS is to prohibit these types of contracts without exception.

This restatement of policy is effective as of the date of this memorandum. States which relied on the contract purchasing manual and issued procurement policy permitting CPPC contracting will be held harmless provided they immediately rescind that policy. Contracts with CPPC options may not be renewed or extended; agencies currently holding CPPC contracts should be given no longer that six months to conduct negotiations necessary to bring those contracts into compliance.

If you have any questions, please let us know.

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